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HISTORICAL DEVELOPMENT OF MONEY AND BANKING IN ERITREA FROM THE AXUMITE KINGDOM TO THE PRESENT

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Abstract

The development of money is an abstract of the history of civilization. Financial institutions encourage saving habit among the people by receiving deposits from the public in various forms. The Axumite kings were the first to mint coins in the African Continent. The aim of this paper is to explore the lessons learned from the different historical developments in the country and the region. The paper discusses the origin of banking system in Eritrea. It highlights the historical evolution and growth of money and banking in Eritrea during the Axumite, Italian, and the British, Ethiopian periods. It also provides the chronological development of money and banking from historical times to the post-independent Eritrea. It also deals with the existing banking institutions in the country. The paper makes an extensive use of related literature in enlightening the money and banking system in Eritrea during the historical period. It ends with summary and concluding remarks.

Keywords: Money; Banking; Eritrea; historical development; Banking institutions.
JEL Codes: G21; N01; N27; O11

1. INTRODUCTION

The precious metals, in weighed quantities, were a common form of money in ancient times. The transition to quantities that could be counted rather than weighed came gradually. Many primitive forms of money were counted just like coins. Cowrie shells, obtained from some islands in the Indian Ocean, were a very widely used primitive form of money—in fact they were still in use in some parts of the world (such as Nigeria). The cowrie play as money in ancient China that its pictograph was adopted in their written language for money (Davies, 2002: 36). Thus it is not surprising that among the earliest countable metallic money or coins were cowries made of bronze or copper, in China. In addition to these metal cowries, the Chinese also produced coins in the form of other

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objects that had long been accepted in their society as money e.g. spades, hoes, and knives.¹ Crossely, and Blandford (1975) viewed that the use of tool coins developed in the West and the ancient Greeks used iron nails as coins, while Julius Caesar regarded the fact that the ancient Britons used sword blades as coins as a sign of their backwardness.

These quasi-coins were all easy to counterfeit and, being made of base metals, of low intrinsic worth and thus not convenient for expensive purchases. True coinage developed in Asia Minor as a result of the practice of the Lydians, of stamping small round pieces of precious metals as a guarantee of their purity. Later, when their metallurgical skills improved and these pieces became more regular in form and weight the seals served as a symbol of both purity and weight. The first real coins were probably minted some time in the period 640 - 630 BC. Afterwards the use of coins spread quickly from Lydia to Ionia, mainland Greece, and Persia (Davies, 2002).

In China, the issue of paper money had become common from 960 AD onwards but there had been occasional issues long before that. A motive for one such early issue, in the reign of Emperor Hien Tsung 806-821, was a shortage of copper for making coins. A drain of currency from China, partly to buy off potential invaders from the north, led to greater reliance on paper money with the result that by 1020 the quantity issued was excessive, causing inflation. In subsequent centuries there were several episodes of hyperinflation and after about 1455, after well over 500 years of using paper money, China abandoned it (Davies, 2002:43; Rena, 2004).

The invention of banking preceded that of coinage. Banking originated in ancient Mesopotamia where the royal palaces and temples provided secure places for the safe-keeping of grain and other commodities. Receipts came to be used for transfers not only to the original depositors but also to third parties. Eventually, private houses in Mesopotamia also got involved in these banking operations and laws regulating them were included in the code of Hammurabi (Crossely, and Blandford, 1975; Davies, 2002).

The origins of money in its various forms, and of banking, are discussed in a book written by Glyn Davies. Some of the points he stressed are: money did not have a single origin but developed independently in different parts of the world. Many factors contributed to its development. Money performs a variety of functions and the functions performed by the earliest types were probably restricted initially and would not necessarily have been the same in all societies. According to Davies, money is fungible. He points out that the most celebrated example of competitive gift exchange was the encounter, around 950 BC, of King Solomon and the Queen of Sheba. He stated that "extravagant ostentation, the attempt to outdo each other in the splendour of the exchanges, and above all, the obligations of reciprocity, were just as typical in this celebrated encounter, though at a fittingly princely level, as with the more mundane types of barter in other parts of the world" (Davies, 2002:13).

Davies described Cattle as mankind's first working capital asset. The religious use of cattle for sacrifices probably preceded their adoption for more general monetary purposes. For sacrifice quality without spot or blemish - was important but for monetary purposes quantity was of more significance since cattle, like coins, can be counted. Obviously there were very practical reasons for the association between cattle and wealth but anthropological evidence from Africa in very recent times shows that when cattle are

regarded as a form of money, not only health cattle but also scrawny ones will be valued to the detriment of the environment supporting them and their owners (Davies, 2002:41-43).

Glyn Davies quotes linguistic evidence to show how ancient and widespread the association between cattle and money was. The English words "*capital*", "*chattels*" and "*cattle*" have a common root. Similarly "*pecuniary*" comes from the Latin word for cattle "*pecus*" while in Welsh the word "*da*" used as an adjective means "*good*" but used as a noun means both "*cattle*" and "*goods*". Glyn Davies also cautions that "one should not confuse the abstract concept of an ox as a unit of account or standard of value, which is its essential but not only monetary function, with its admittedly cumbersome physical form. Once that is realized (a position quickly reached by primitive man if not yet by all economists or anthropologists), the inclusion of cattle as money is easily accepted, in practice and logic." He also points out that until well into the present century the Kirghiz of the Russian steppes used horses as their main monetary unit with sheep as a subsidiary unit. Small change was given in lambskins.

It is understood that the development of money is an abstract of the history of civilization. A complete definition of money should be comprehensive enough to embrace all the essential functions which money performs in the economy such as a medium of exchange and standard measure of value. In today's world of development, banks have become a part and parcel of our life. Especially, the role of banks is more in the third world countries, as these countries are expected to undertake various challenging tasks to promote development. Banks cater to the needs of agriculture, industry, trade, commerce, insurance etc (Rena, 2004).

Bank is as a business establishment that safeguards people's money and uses it to make loans and investments. Banking institutions have been acting as intermediate houses between the primary lenders and the final borrowers. They borrow funds from those who are willing to give up their current purchasing power and lend to those who require the funds for meeting the current expenditures. Banking institutions indeed can contribute to the economic development of any country in the following ways. Banking institutions encourage saving habit among the people by receiving deposits from the public in various forms. Generally, they mobilize the savings of the people through the issue of debentures, unit certificates, savings certificates, chits, subscriptions etc (Rena, 2004). Economists have stressed the importance of commercial banks in the process of economic development from time to time. Even in Eritrean economy, banking institutions play a vital role in various ways. By encouraging thrift among people, commercial banks have fastened the process of capital formation in the country. In the deposit mobilization, commercial banks induce the community to hold their savings in the form of socially useful assets i.e. bank deposits.

1.1 Organization and Methodology of the Study

The history of modern money and banking in Eritrea dates back to the early twentieth century. In fact, it can be asserted that the financial institutions in Eritrea are as young as the nation itself. The following part of this article provides a brief account of the history

of money and banking in Eritrea from the historical periods to the present. The main objective of this paper is to examine and discuss the historical development of money and banking in Eritrea (starting from the Axumite Kingdom). An attempt is also made to discuss the banking development in post-independent Eritrea. The paper sheds a light on the evolution and development of the banking in Eritrea, which could help the researchers and policy makers. The organization of the paper is as follows. Section two provides an analysis of the historical development of money and banking in Eritrea. And section three deals with the banking institutions in the post-independent Eritrea and the last section ends with summary and concluding remarks.

This paper is mainly based on secondary data collected from the Research and Documentation Center, Asmara. Besides, the data are also collected from the related books, journals and government reports, reports from the banks, the relevant data also been obtained from the Internet sources as cited in the article. This paper provides a descriptive analysis of the historical data of the money banking pertinent to Eritrea. The paper discusses some important issues of money and banking from Axumite period to post-independent period. Although there were very few scholars attempted to work in this area like Mauri (1998 and 2003) Tschoegl, (2001), Pankrust , 1961, 1965). But most of those works address either the Axumite period or the Italian periods only. No much work has been done on the money and banking in Eritrea from Axumite period to independence period. Hence, to fill some of the glaring gaps this study has been undertaken.

2. HISTORICAL DEVELOPMENT OF MONEY AND BANKING IN ERITREA

2.1 Profile of Eritrea

The foundation of the state of Eritrea came into being during the Italian Colonial Period. Before this, a number of different kingdoms existed in the present-day Eritrea, the Axumite Kingdom (1st-9th century), the seven Beja Kingdoms (8th-13th century), and the Bellou Kingdom (13th-16th Century), over the centuries; other kingdoms and empires also established outposts to control over various parts of Eritrea. Turks and Egyptians also invaded and ruled Eritrea. Italy invaded Eritrea in 1890, and issued a decree, which turned Eritrea into a colony. Italians governed Eritrea till 1941. During this period, substantial economic development, particularly in infrastructure, took place to meet the colonial needs of Italy. Eritrea also experienced widespread displacement of its indigenous population during this period, resulting in a disruption of the existing form of society. During World War II, the British defeated the Italian forces in the Horn of Africa and established a protectorate over Eritrea. Eritrea became an important center for British and American operations in the region during the war.

In 1952, following a United Nations resolution, Eritrean was federated with Ethiopia. In 1962, Ethiopia's emperor, Haile Selassie, unilaterally dissolved the Eritrean parliament and annexed the country. The struggle for independence began in the early 1960s, after years of protest (World Bank, 1994; Rena, 2005:40-56). The conflict between Eritrea and Ethiopia further intensified following the military coup in Ethiopia in

1974, which replaced Haile Selassie by a Dergue² regime headed by Mengistu Hailemariam. Eritrea's struggle for independence that lasted for three decades was one of the longest in Africa's history. On 24 May 1991, the Eritrean People's Liberation Front (EPLF) finally took full control of Eritrea. Following an internationally supervised referendum, Eritrea formally gained its independence on May 24, 1993.

Eritrea is bordered on the north-east by the Red Sea, on the south-east by Djibouti, on the south by Ethiopia and on the west and north-west by Sudan. Eritrea is also bordered with Saudi Arabia and Yemen across the Red Sea. The 45,754 square miles, which make up Eritrea, include over 350 islands off the coast, of which 210 comprise the area of the Dahlak Archipelago. Eritrea's Red Sea coastline extends for about 1200 kilometres (700 miles) from the northern border with Sudan at Cape Kasar, to the southern extension of the Red Sea in the straits of Bab-La-Mandeb at Cape Dumeira. The population of Eritrea is about 4 million out of these about 1 million live outside the country, basically owing to the colonial situation that prevailed in the country for three decades. It has nine ethnic groups and six administrative provinces.³ There are four banks in Eritrea, like: Bank of Eritrea, Commercial Bank of Eritrea, Housing and Commerce of Bank of Eritrea, Eritrean Development and Investment Bank (Rena, 2006).

2.2 Money in the Axumite Kingdom

The Axumite kingdom was one of the strong ancient kingdoms that existed till the eighth century AD with its centre in Northern part of Ethiopia. The largest portion of Eritrean highlands was part and parcel of this ancient kingdom. The coins are important sources of history and symbol of foreign trade and commerce. It is to be noted that the Axumite Kings were the first to mint coins in the African Continent (Pankhurst, 1965). These coins were made of gold, silver and bronze. However, no one knows the exact time when minting of coins started in Axum. Some archaeologists endorse the view that Endybis was the first king to introduce gold coins in his name around the third century AD.

In the 3rd century AD, coins were minted, with inscriptions in Greek and the indigenous Semitic language- Ge'ez. As explained in the first part of this article, all sorts of physical items were used as money by different societies. The second king to strike similar coins in his name was Aphilas. After Endybis and Aphilas each succeeding Axumite sovereign introduced his own coins with his image and insignia (Pankrust, 1961; Rena, 2005 38-40). The other views also advocate that the first kings to mint coins were: Endybis, Aphilas, Osanas, Wazieb - I, Wazieb - II, and Taziena. These coins⁴ indicate the names of the kings, and religion. The Axumite coins show that there were extensive trade relations with the Greek and Roman World (Pankhurst, 1965; National Bank of Ethiopia, 2002a; Rena, 2005: 39).

In ancient history, an outstanding feature of trade between the Mediterranean countries and the Eritrean Sea was the use of money. Along the route from Adulis(Eritrean coast), the principal outlet to the sea of the ancient civilization to cities like Kohaito (Coloe), Keskesse, Metera (Belew Kelew) and others, archaeologists have uncovered coins from those days (Pankhurst, 2002; Rena, 2005).

After the downfall of the Axumite Kingdom, the following ten centuries, it is found that the minting or the use of coins was discontinued indefinitely (Rena, 2005). In the mean time, then people (in present Eritrean territory) were using a barter system of exchange using primitive money forms like: bar of salt, articles of clothing (*fergi*, *abujedid*), small iron bars, honey, butter, rifles cartridges, crops and cattle. The primitive money⁵ was used in some part of Ethiopia and Eritrea. History has recorded lots of such commodities (Pankhurst, 2002:4). In many instances, scarce goods served as medium of exchange (Pankhurst, 1961:13-18).

2.3 Money and Banking in Italian Colonization Period (1890-1941)

Maria Theresa *thaler*⁶ is a coin named after Maria Theresa, an Empress that controlled Austria (Pankrust, 1965; Hablesellasse, 1972). The silver *thaler* coin, embossed with the head of the Empress Maria Theresa, has a fascinating history. The Maria Theresa *thaler* continued to be minted in Vienna (bearing the date 1780 the year in which the empress died) down to 1914 because it was preferred in some part of the present day Eritrea, Ethiopia and Arabia (Pankrust, 1961: 71-83; Rena, 2005).

When the Italians colonised Eritrea in 1890 the first thing they did was to replace the Maria Theresa *thaler* with their own currency lire, and *Thalero Eritreo* (Mauri, 1998). The subsequent Fascist coins bearing Mussolini's face and jutting jaw were virtually ignored by the merchants. In other words, the first modern forms of banks were established with the advent of Italian rule. These coins were designed to be the same size and shape as the more renowned Maria Theresa *thaler*. Yet, Italians failed to convince the people of the similarity in the coins because *Thalero Eritreo* had less intrinsic value than the *thaler*. As a result, there were some institutional problems cropped up in managing the lire and *Thalero Eritreo* in the place of *thaler*. The people were not willing to accept it in the beginning. However, step-by-step, when the Italians were well established their administration and addressed the problems. The administration asked all the people to change their money into either lire or *Thalero Eritreo*. *Thalero Eritreo* was minted in Rome and appeared in Asmara in 1890 (Killion, 1998; Rena, Tschoegl, 2001; 2005: 76-80).

In 1914 an Italian bank⁷ (*Banca d' Italia*) established its branch offices in Asmara and Massawa and was a first modern bank that has set its foot in the country. This is major institutional development to drive out the *thaler* from the circulation and the bank helped two Italian currencies: *Thalero Eritreo* and the Italian lira. Soon the former was withdrawn and only the Italian lira prevailed (Gebreegziabhier, 1999: 3).

The establishment of a Bank of Italy branch in Asmara remained an issue of studies and discussions for the next few years without any concrete development (Mauri, 1998). After 1914 there was fairly steady growth of the total bank notes. The supply of notes, however, was to some extent elastic. On the other hand, the supply of notes expanded and contracted following seasons and the needs of business. At the end of 1921 the virtual circulation of notes in Eritrea reached a total of almost 30 million lire, of which 6 million in state notes and the rest in bank notes of various denominations. These figures did not

take account of notes exported directly and informally from the Colony (or better of the balance between outflow and inflow of notes outside official channels) and of notes been destroyed ((Mauri, 2003).

The Bank of Italy, at first, manifested its interest in principle, but added that the implementation of the project would have required a series of procedural steps.⁸ First of all; there was no evidence of initiatives of this kind by central banks of countries having colonial empires. Secondly, the Eritrean branch found difficult to become viable in the space of few years, even if it was to handle the treasury service for the colonial government. Thirdly, local authorities were unwilling to grant public contributions to the Bank of Italy branch. Lastly, there were serious difficulties of legal and regulatory nature owing both to the lack of specific provisions regarding banking business within the commercial legislation framework of the Colony and to administrative constraints set up by the *Banca d'Italia's* statute and by the rigid regulations drawn up within the bank itself (Mauri, 2003).

In the early twenties, the banking system in Eritrea consisted of an autonomous branch of the Bank of Italy which combined operations pertaining to commercial banks with the activity of central bank and of two private banks. One belonged to the co-operative movement, had a definitely local character and was assisted by the Bank of Italy, while the other, with bias towards foreign trade business, was linked to a large Italian bank. There were in the Colony a total of six bank branch offices or sub offices located as follows: two in Asmara, two in Massawa, one in Keren and one in Adi Keyi. The favourable conditions for Eritrean economic development resulting from the export boom during the war period were, however, only transitory. The impetus of growth did not survive long and foreign trade declined and the fall in exports was accompanied by a fall in prices of raw materials in international markets. The sharp reduction of demand from abroad threw the economy of the Colony into a serious crisis. All the principal market oriented productive sectors were hit and all domestic prices, even of imported goods, fell. In particular, there were falls in the prices of silver, and of both urban and rural real estates (Mauri, 1998).

Further, with the Italian occupation of Ethiopia in 1936 *Banco di Napoli* and *Banco di Roma* set their branches in Asmara, Massawa, and Assab. During the occupation, other banks with specific functions were in operation. The first of this is *Banca Nazionale del Lavoro* with branches in Asmara and Decamare. The other credit house (*Casa Di Credito*) was mainly an agricultural and credit institute with its centre in Asmara (National Bank of Ethiopia, 2002^b:1-2).

2.4 Banking in the British Administration (1941-52)

In April 1941, the British defeated Italy and took the control of Eritrea. The British realized how popular the Maria Theresa *thaler* was, and minted in India the exact replicas of the old Austrian coin. These also proved so popular that the coins rapidly disappeared under mattresses or were hidden in dhows bound for Arabia. Strict controls were introduced, but the coins were hoarded as currency right up to the end of the 1950s

(Sutton, 2003). During this period, the first modern types of banks were established. By 1941, there were four banks and one credit institute in the country.

Barclays Bank was largely controlled banking business in Eritrea during the British administration. It is important to note that, unlike the Italians, the British extended banking services to the local people. This was a milestone in the transfer of banking skills to Eritreans (Pankrust, 2002; Rena, 2005). Only two months after Asmara had been occupied, Barclays Bank (DCO) had completed its arrangements to open a branch there at the request of the British administration, which was anxious to have the affairs of the Italian banks examined without delay, so that they might be reopened under the British supervision as soon as possible (Crossley and Blandford, 1975:13).

In 1941, the Italian civilian population, including refugees from Ethiopia, was estimated between sixty and seventy thousand but the four Italian banks in Asmara had as many as 52,000 accounts on their books. They were allowed to reopen many accounts under the strict supervision and for dealings in lira currency only. Barclays' new branch (when it opened in the old premises of the Banco Nazionale del Lavoro) had the distinction of being the best in service (Crossley and Blandford, 1975: 13). The economic condition of Eritrea had suffered severely from the British blockade; stocks were down to an extremely low level. At the end of 1941, plans for an American base at Asmara (Kognaw camp) began to take shape. This project was first of its kind attempted by Americans on the African continent. This camp offered employment for most of the workless population in Eritrea; however, Americans did not set up any banking institution (Rena, 2005; Stephen, 1974).

In addition to the plans for the Asmara Arsenal, where a few thousand American servicemen were expected in 1942, it was proposed to import aircraft through the port of Massawa to be partially assembled there before being finished off at *Gura* and *Mai Edaga*, formerly the Italian *caproni* aircraft establishment. On account of these activities an agency of Barclays bank at Gura was opened on 3 April 1942. A few weeks later the Branch at Massawa was opened on 20 April 1942, with Norman Palmer as manager. While the agency was discontinued on 31 August 1943, both Asmara and Massawa branches served until 1952 (Crossley, and Blandford, 1975: 14; Trevaskis, 1960).

During this period, currency matters were of particular interest. It was necessary at first to ensure that the currency the troops brought with them would be fully acceptable and this resulted in East African Shillings, Indian rupees, English pounds and Maria Theresa *thaler* all being made legal tender. In January 1942, the British decided that British East African currency should be the standard legal tender and a currency reserve was also established. This enabled Asmara branch to reduce its bulky cash holdings. Four months later, in order to reduce the volume of East African currencies in circulation, the Italian banks were authorized to open accounts in that currency, subject to re-depositing eighty-five percent with Barclay bank in current account. The constant accumulation of lire notes by the authorities led to a famine in small change, while much of the currency put into circulation in the early days was either hoarded or smuggled out to the Sudan and the Arabian coast. At no time were the banks allowed to exchange lire for East African currency or vice versa. Black market dealings, however, took place at rates, which fluctuated with military fortunes (Crossley and Blandford, 1975: 14; Stephen, 1974).

These, together with sterling and the metropolitan lira, which was made legal tender in respect of notes and coin of 50 lire and under, made quite a formidable list. This lire currency was necessary to provide small change for the everyday purposes of the community and was accepted by the administration in payment of taxes and for other purposes. It was not uncommon for the finance officers to lodge with the bank a cubic yard or more of these notes at one time, and the twelve safes were at times crammed with notes to a value of over a hundred million lire (Trevaskis, 1960; Stephen, 1974; Rena, 2005).

2.5 Banking in Ethiopian Regime (1952-1991)

After the completion of British administration, Eritrea was federated with Ethiopia in 1952. Consequently, Eritrean banking system was subjected to the regulation of the State Bank of Ethiopia. In 1963, Addis Ababa Bank opened a branch office in Asmara, and the existing commercial banks were left to compete in the market. Nevertheless, the possible lack of political support for Banco di Roma and Banco di Napoli (the two Italian banks in the market at that time) lead to their withdrawal in 1967(National Bank of Ethiopia, 2002^a: 5).

In 1974, the socialist (*Dergue*) regime in Ethiopia took over Emperor Haile Sellasie's Monarchy. Thus, the banking sector was changed into a mono banking system with the rule of the command economic system. The Commercial Bank of Ethiopia became the only bank rendering universal banking services to the public. The commercial bank then was reformulated in 1980 by amalgamating all assets and liabilities of the old Commercial Bank of Ethiopia and the Addis Ababa Bank. The objective of the bank during the period was rendering commercial banking services with special favour for public enterprises and service cooperatives, while denying appropriate attention for the private sector. The bank was also in operation under the guidelines that restrict its scope to provide only short term lending for about one year (National Bank of Ethiopia, 2002^b). Each bank had a strict credit ceiling beyond which it has to gain approval from central bank for disbursement (National Bank of Ethiopia, 2002^a: 7).

Since the inception of the Italians, it is observed that the Eritrean banking system has experienced successive failures and reformulations. This continuous process of amalgamation and liquidation has at times disrupted the whole economy with severe social and economic repercussions. In 1991, the thirty years armed struggle culminated in Eritrea's independence from Ethiopia. The bank's that were formerly acting as branch banks of the Ethiopian Commercial Bank were simply reorganised to formulate the Commercial Bank of Eritrea (CBE). It is found that the new bank had little capital and deposits in the beginning and had to start from scratch.

At the end of the British administration, the banks in Eritrea were directly or indirectly under the control of the centralised management of the Ethiopian Commercial Bank. It is observed that the long liberation struggle in Eritrea during 1961-1991 had a significant impact in the deterioration of the banking system. This was widely evident during the Dergue regime in Ethiopia. It is also observed that commercial banks in Eritrea, then branches of the Commercial Bank of Ethiopia, were largely serving the political cause of

the Ethiopian government. Hence the banks have not grown at the pace of growth that they experienced during the Italian and British occupation (Stephen, 1974; Rena, 2005). Despite the different experiences banking had undergone in Eritrea, the following facts are common throughout its history. First, banking in Eritrea had always served the purposes of the regimes that administered the country and not the ordinary Eritrean people. Secondly, the instability of the regimes had always led to the short-sightedness of the goals established by the banks. The fact that the banks were largely entitled to make short-term loans was a sheer reflection of this. Thirdly, private sector participation in the banking system is weak and needs strong government incentive, as was the case during the Italian and British occupation of Eritrea (Trevaskis, 1960).

2.6 Money and Banking in Post-independent Eritrea (1991-2003)

Although, Eritrea got independence in 1991 but the first Eritrean currency, the *Nakfa* ⁹, was launched on 8 November 1997 and replaced the Ethiopian *birr*. With the introduction of the *Nakfa*, Eritrea has entered a new phase in its history (Sutton, 2003; Rena, 2006). It may seem strange, at a time when countries such as those of the European Union are trying to create or revive pan-national regional currencies, that Eritrea is devising a new one. However, there are economic reasons why Eritrea took the important step of introducing its own currency. During the seven-year common currency era, the Ethiopian monetary authorities conducted a monetary policy for the *birr* as a whole. Eritrea was not in a position either to conduct its own monetary policy or to influence Ethiopian monetary policy. As the currency-issuing authority, the National Bank of Ethiopia was the sole beneficiary of the seignior age that accrued as a result of monetary expansion. Taking all these backdrops into consideration, and to protect Eritrea's national interest, the Eritrean currency was introduced (Rena, 2006).

For the first time, Eritrea has the authority to formulate and conduct its own monetary and foreign exchange policy. The Bank of Eritrea, the country's apex bank, has established policies based on market principles. It has been regulating the foreign exchange for visitors coming into and leaving Eritrea (Sutton, 2003; Rena, 2006). The Bank of Eritrea and its sisterly banks function according to the guidelines given by the International Monetary Fund and the World Bank.

3. BANKING INSTITUTIONS IN POST-INDEPENDENT ERITREA

3.1 The Bank of Eritrea

Prior to independence of Eritrea, the Bank of Eritrea was a branch of the National Bank of Ethiopia. At that time, the Bank carried out limited and subordinated central banking functions like exchange control service, local transfer services, supply of *birr* notes to the other branches of Commercial Bank of Ethiopia (CBE), clearing house for check drawn on CBEs, maintaining government accounts, redeeming deteriorated *birr* notes, licensing and auditing micro finance institutions established in the names of employees of various organizations. The financial system then existing in Eritrea was

composed of banks and financial institutions of Ethiopia. Hence, the condition of the Bank of Eritrea was not conducive particularly due to the shortage of trained, adequately educated and experienced staff in the areas of central banking¹⁰ as well as inadequate building, poor communication and office facilities. Internally, the Bank has also taken steps to create an environment aimed at enhancing productivity of its human resources, the provision of appropriate facilities including office space, equipment and other institutional support.

In July 1996, the Bank had shifted from its office building at *Godena Harnet* to its current office at *Nakfa* Street. The legal status of the Bank for its specialized activities was not been clear until the issuance of its proclamation (Government of Eritrea, 1997^b; Rena, 2006:2). It is observed that the Government of Eritrea provided a congenial environment for the development of an effective central bank with an important policy and legislation. Eritrea's Macro policy spells out the foundations of private market-led, export-oriented economy (Government of Eritrea, 1994; Rena, 2006:1)). As of March 10, 1997 the long awaited Bank of Eritrea and Financial Institutions Proclamations were enacted. The Bank proclamation 32/1993 allowed Bank of Eritrea to establish an independent and liberal Central Bank. The Bank of Eritrea has empowered with the authority to conduct an independent monetary policy (Government of Eritrea,1997^b). The Financial Institutions Proclamation establishes the bank as the regulatory and supervisory agency for financial institutions (Government of Eritrea,1997^a).

The principal objective of the Bank of Eritrea is to manage money and credit in the economy. The bank shall pursue stability in prices, maintain sound exchange rate policy and foster economic growth, employment and overall development in the country. It shall promote a sound financial system in the country. A Board of directors, which is responsible for the management, and administrative policy, control the Bank (Government of Eritrea,1997^b). The Bank of Eritrea issues bank notes and coins. As a banker to the government the Bank shall act as banker and fiscal agent of and advisor to the government. The Bank in consultation with the Government shall determine the exchange rate system for the Eritrean currency. As a banker to the other depository institutions, it may accept deposits from depository institutions and also grants advances to them for time periods (Government of Eritrea, 1997^c). The Bank influences the supply of money and credit, and issue regulations with respect to the level of interest and foreign exchange rates (Government of Eritrea, 1997b).

3.2 Commercial Bank of Eritrea

Under the Proclamation (number 49) issued on 31 January 1994, Commercial Bank of Eritrea (CBE) formally established. The Bank is the sole institution in the country providing full retail commercial banking services. It is the largest commercial bank in the country. The CBE is entrusted with a wide range of financial activities such as stimulating agricultural production; export promotion, rural development and encouraging and financing working capital requirements of the industrial sector. Besides, promotion of savings, provision of credit, promotion of foreign exchange and trade and thus playing a vital role in the development of Eritrean economy. Currently, the bank has

a network of seventeen branches and one central office, which administers the branches. The bank services are however, limited to a few areas in the country thus the bank unable to service the growing needs of the population (Commercial Bank of Eritrea, 1994; Rena, 2006: 8-10). The Bank, deposits increased from Nakfa 365 million in 1991 to Nakfa 13.6 billion in 2004, where as the amount of loans and advances increased from Nakfa 86.4 million to 3.53 billion during the same period. These deposits are used in the economic development of the country in various projects of industry, agriculture even services. Many large businessmen and agricultural estates like Elobred, Alighider and Afhimbol are benefited by the commercial bank loans.

Although the bank still dominates the banking business in the country with more than 90 per cent of the countries deposits and 80 per cent claims on the private sector, it is not making any profit on its main business (Von Eije et al, 2003). The reason for this is that the bank is suffering from chronic excess liquidity (CBE, 2003). In 1998, only 29 per cent of its deposits were forwarded as loans and advances to costumers. Hence, the bank cannot raise enough income to pay depositors, and its return on assets (ROA) and return on equity (ROE) were only 0.6 and 21 percent respectively. The income of the bank comes from other sources: mainly from foreign currency transactions and banking service charges (CBE, 1998).

3.3 Housing and Commerce Bank of Eritrea

It was established as a share company on 1st January 1994, and renamed as Housing and Commerce Bank Share Company. At present, the bank has nine functional branches,¹¹ located different parts of the country (Housing and Commerce Bank, 2003). The basic objective of the Housing and Commerce Bank of Eritrea (HCBE) is to provide loans for housing development for those interested customers who are eligible to fulfill the bank's rules and regulations incorporated in the credit system. The bank provides loans to the individuals who want to construct their dwelling houses, commercial buildings, garages, stores etc. Indeed, the bank itself constructed housing complexes in Asmara, Massawa Keren cities and sold to various customers both inside and outside (Eritrean Diaspora) of the country. It also provides loans to legally organized housing cooperative societies for constructing dwelling houses. Loans may be provided to the state enterprises for constructing offices, stores, staff residence and entertainment clubs. It provides loans for repair, maintenance, modification, renovation and extension of existing buildings (Housing and Commerce Bank, 2003; Rena, 2006:18-25). The Bank has been involved in international banking activities since 1997.

The Deposits of bank grown from Nakfa 30.4 million in 1994 to Nakfa 3 billion in 2003 showing an average annual growth rate of 53 per cent. The overall Loan Portfolio of the Bank for the first 5 years had shown tremendous growth, from Nakfa 105 million in 1994 to 801 million in 1998, the average annual growth being 50 per cent. However, the year 1999 saw a decrease of 33 per cent compared with the peak in the year 1998 due to the border conflict with Ethiopia and started to revive again in the years 2000 – 2003 (HCBE, 2003).

3.4 Eritrean Development and Investment Bank

The Eritrean Development and Investment Bank (EDIB) was formally established on 28 October 1996 through a Proclamation 91/1996 with an expectation that it will play a vital role in the mobilization and effective utilization of the financial resources in the country to meet the long-term resource needs of viable private enterprises. However, it started banking operations in May 1998 (Rena, 2006: 30-32; World Bank, 2002). In general, the bank is mandated to play a vital role in accelerating economic development of the country through mobilizing and consequently financing to those development oriented-projects like agricultural, industrial, mining, tourism, constructions and other sectors of the economy (World Bank, 2002; Rena, 2006). The bank has been focusing its activities on term lending (EDIB Reports).

4. SUMMARY AND CONCLUSION

The paper offers an overview of the early stages of monetary and banking development in Eritrea particularly at the time when it was under Italian colonial rule. The foundations of the monetary and banking system in the country occurred in the first two decades of the Italian occupation, at the time when the Colony benefited of the favourable economic conditions resulting from the export boom during World War I. The Bank of Italy, in those years, played a leading role in promoting the financial development process. This policy was implemented by widening the monetary area and by supporting actively the establishment of autonomous financial institutions. During this period, the modern types of banks were established in Asmara and some other cities in Eritrea. Prior to this, traditional financial intermediaries such as saving associations existed and facilitated the financial transactions for centuries in this territory. The Italians established four banks in Eritrea, namely, *Banco Nazionale Del Lavoro*, *Banco Di Italia*, *Banco Di Napoli* and *Banco Di Roma* during their colonial rule. During the British period, *Banco Di Italia* and *Banco Nazionale Del Lavoro* were established and all in all there were four banks and one credit institute were existing in the country. The British troops brought with them East African Shillings, Indian rupees, English pounds and Maria Theresa *thaler* all being made legal tender. After the British, the banks were under the control of the centralised management of the Ethiopian Commercial Bank. The third liberation struggle in Eritrea had a significant impact in the deterioration of the banking system. Hence, the banks during the Ethiopian period have not developed well.

During the federation period, the State Bank of Ethiopia opened a branch in Eritrea and began to compete with the Italian banks. Later on the State Bank of Ethiopia was split into the National Bank of Ethiopia and Commercial Bank of Ethiopia expanded quickly to take advantage of the relatively advanced industrial and commercial base built by the Italians. After Eritrean independence, Bank of Eritrea, Commercial Bank of Eritrea, Housing and Commerce Bank of Eritrea and Eritrean Development and Investment Bank were established. These banks play a great role in the development process. During the seven-year common currency period, the Ethiopian monetary

authorities conducted a monetary policy for the *birr* but not Eritrea. Hence it is understood need of its own currency and introduced.

It is strongly believed that the existing banks in Eritrea would facilitate the transfer of purchasing power, by connecting savers with investors. All these banking institutions are contributing substantially to fill the budget deficit of the country due to the border conflict with Ethiopia (1998-200). Due to the on going economic crises, these banks are catering the needs of business communities. When the financial system develops in the country, other financial institutions emerged. As stated in the Macro Policy, the government of Eritrea has been working on to develop an "internationally competitive financial center" in the region. In line with this, it has to develop new banking institutions and expand the existing commercial banks, savings and loan associations, insurance company, pension funds etc., to strengthen its financial capacity and thus develop Eritrea as a model nation in Africa.

Notes:

1 Although there is some dispute over exactly when these developments first took place, the Chinese tool currencies were in general use at about the same time as the earliest European coins and there have been claims that their origins may have been much earlier, possibly as early as the end of the second millennium BC.

2 Dergue - Amaharic word for council and the abbreviation Provisional Military Administrative Council the ruling body in Ethiopia since 1974 - 91.

3 Eritrea has nine ethnic groups. They are: Tigigna, Tigre, Saho, Afar, Bilein, Hidareb, Kunama, Nara and Rashaida. All these ethnic groups have their own languages and cultures. There are six administrative regions: Anseba, Debub, Maekel, Gash Barka, Southern Red Sea, Northern Red Sea.

4 Up to 1926, more than five hundred coins (that circulated in this area) were archeologically discovered. Out of these 173 were of gold, 18 of silver and 322 of copper. These coins were used for internal and external trade. According to a French author A. Kanmerer, the coins had the pictures of the rulers surrounded by palm leaves on one side and crescent on the other side (Pankrust, 1961; Stuart Munro-Hay, 1991; Rena, 2005).

5 Articles like animal skins, small decorative ornaments (such as glass beads, cowry shells, brass bracelets), salt bars (amolie), cloth, cattle, cartridges, were used as primitive money at different times in the Axumite Kingdom.

6 The Maria Theresa thaler, a silver coin (0.8333 fine) minted in 1780 in Austria as a legal tender. However, it was widely used for domestic trade as well as for trade with Ethiopia and the opposite side of the Red Sea, even though introduction of this commodity money into territories under Ottoman rule was unlawful. The thaler was a full-bodied money, used as means for trade as well as for unilateral payments: tributes, compensations for killing and injury. The thaler was widely accepted in the largest part of the Horn of Africa. Hence, it continued to serve as a medium of exchange (at least de facto) till the coming of Italians. According to Pankhurst (1965) and other authors the Austrian coin besides its use as money, i.e. means of payment, standard of value and store of value, also performed important non-monetary functions: in fact it served as jewel, as a certified source of silver for melting down and even as a measure of weight (28.0668 grams). The thaler continued to be the principal medium of exchange in the Colony, but this money was not flanked by fractional coins and therefore small Italian pieces became quite popular among

the natives. Inland the colony, exchanges were carried on also by barter or by the use of commodity money. Alongside thalers, various types of primitive money served for payments.

7 The first bank established in Eritrea was a branch of Bank of Italy, whose home office was in Rome, but this important event occurred many years after the first Italian settlement in the Horn of Africa and after the founding of the Colony in Eritrea. Appeals and petitions to have banking services in Eritrea made repeatedly both by the Italian and other foreign business communities residing in the Colony were not given due attention in Rome for some decades. In 1885 Hassan Moussa el Akad, an Egyptian businessman, had submitted to the Italian authorities a project for the creation of a bank which would provide both commercial loans and mortgage loans. However, the request was turned down by the Italian authorities in order not to create difficulties with the Foreign Office in London. According to information obtained, the Egyptian banker appeared to be involved in an anti-British movement in his country. Consequently, more than a quarter of a century was to pass before a bank office was established in the colony (Mauri, 2003).

8 Accordingly, in 1906, following proposal by the Board of Directors, a shareholders meeting of the Bank of Italy voted in favour of opening an Eritrean branch and a mission was sent to Asmara to make a feasibility study of the project. The conclusion was not encouraging, hence the project delayed till 1914.

9 Nakfa is a mountainous town in Eritrea, which provided a strong base for the Eritrean liberation fighters to fight against Ethiopian soldiers during the period 1975-1985. It rises from ashes like the Sphinx to heal the scars of the long years of war. As a result, until independence, Nakfa was only military base with hardly any civilian residents. To commemorate all the important history of the town Nakfa, the Eritrean currency was named in 1997. Eritrea, for technical and economic reasons, did not introduce its own currency immediately after its independence; rather it was using Ethiopia's currency Birr until 7th November 1997. Owing to this fact the central Bank was unable to implement its own monetary and financial policies (Rena, 2006:3).

10 At present, Eritrea is facing an acute shortage of skilled and professionally trained bankers to meet the growing needs of the economy. This is particularly true in the banking sector. Although, there was Asmara Commercial College that was offering advanced diploma programme in Banking and Finance during the period 1997-2004, however, stopped due to unknown reasons. Until recently, there was no Eritrean banking college or other training centers to educate skilled bankers.

11 These are the branches of Housing Bank 1)Massawa (Southern Red Sea Zone); 2) Zeraï Deres Square - Asmara (Central Zone); 3) Assab (Northern Red Sea Zone); 4) Sembel - Asmara (Central Zone); 5) Tesseni (Gash Barka Zone); 6) Keren (Anseba Zone); 7) Ghindae (Southern Red Sea Zone); 8) Barentu (Gash Barka Zone); 9) Mendafera (Southern Zone).

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